



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General

Washington, D.C. 20201

MAY 30 2003

TO: Thomas A. Scully
Administrator
Centers for Medicare and Medicaid Services

FROM: Dennis J. Duquette *DJ Duquette*
Acting Principal Deputy Inspector General

SUBJECT: Review of Medicare Contractor's Pension Segmentation, CareFirst of Maryland
(A-07-02-03033)

As part of an ongoing collaborative effort between the Office of Inspector General and the Centers for Medicare and Medicaid Services (CMS), we are alerting you to the issuance within 5 business days from the date of this memorandum of our final report entitled, "Review of Medicare Contractor's Pension Segmentation, CareFirst of Maryland." A copy of the report, identifying an understatement of the Medicare segment assets of about \$6.8 million at CareFirst of Maryland (CareFirst), is attached.

We suggest that you share this report with the CMS components involved with monitoring the Medicare contractor financial operations, particularly the Office of Financial Management, the Center for Medicare Management, and the Office of the Actuary.

CareFirst improperly reallocated pension assets on January 1, 1996, rather than updating the Medicare segment assets from January 1, 1991 as required by the contract. This also resulted in a material understatement of pension plan earnings applicable to the Medicare segment through January 1, 2002. Consequently, we determined that Medicare segment assets were understated by \$6,788,644 as of January 1, 2002. Accordingly, we are recommending that CareFirst increase Medicare segment assets by \$6,788,644 as of January 1, 2002.

CareFirst agreed with our findings and recommendations.

If you need additional information about this report, please contact George M. Reeb, Assistant Inspector General for the Centers for Medicare and Medicaid Audits, at (410) 786-7104 or James P. Aasmundstad, Regional Inspector General for Audit Services, Region VII, at (816) 426-3591.

Attachment



DEPARTMENT OF HEALTH & HUMAN SERVICES

OFFICE OF INSPECTOR GENERAL

MAY 30 2003

Office of Audit Services
Region VII
601 East 12th Street, Room 284A
Kansas City, MO 64106
(816) 426-3591

Report Number: A-07-02-03033

Mr. Charles J. Reip, CPA
Manager, Financial Reporting
CareFirst of Maryland, Inc.
10455 Mill Run Circle
Owings Mills, Maryland 21117

Dear Mr. Reip:

Enclosed are two copies of the Department of Health and Human Services (HHS), Office of Inspector General (OIG), Office of Audit Services' (OAS) report entitled, "*Review of Medicare Contractor's Pension Segmentation, CareFirst of Maryland.*" A copy of this report will be forwarded to the action official noted below for her review and any action deemed necessary.

Final determination as to actions taken on all matters reported will be made by the HHS action official named below. We request that you respond to the HHS action official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

In accordance with the principles of the Freedom of Information Act (5 U.S.C. 552, as amended by Public Law 104-231), OIG, OAS reports issued to the Department's grantees and contractors are made available to members of the press and general public to the extent information contained therein is not subject to exemptions in the Act which the Department chooses to exercise. (See 45 CFR part 5.)

To facilitate identification, please refer to report number A-07-02-03033 in all correspondence relating to this report.

Sincerely yours,

James P. Aasmundstad
Regional Inspector General
for Audit Services

Enclosures – as stated

Directly Reply to HHS Action Official:

Ms. Sonia Madison
Regional Administrator, Region III
Centers for Medicare and Medicaid Services
The Public Ledger Building, Suite 216
150 South Independence Mall West
Philadelphia, Pennsylvania 19106

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF MEDICARE
CONTRACTOR'S PENSION
SEGMENTATION, CAREFIRST OF
MARYLAND**



**JANET REHNQUIST
INSPECTOR GENERAL**

**MAY 2003
A-07-02-03033**



MAY 30 2003

Office of Audit Services
Region VII
601 East 12th Street, Room 284A
Kansas City, MO 64106
(816) 426-3591

Report Number: A-07-02-03033

Mr. Charles J. Reip, CPA
Manager, Financial Reporting
CareFirst of Maryland, Inc.
10455 Mill Run Circle
Owings Mills, Maryland 21117

Dear Mr. Reip:

This report provides the results of an Office of Inspector General (OIG), Office of Audit Services' (OAS) review entitled, *Review of Medicare Contractor's Pension Segmentation, CareFirst of Maryland*.

We determined that CareFirst of Maryland (CareFirst) should increase its segment assets by \$6,788,644 to \$12,553,607 as of January 1, 2002. CareFirst agreed with our findings and recommendations. CareFirst's response is included as Appendix B.

EXECUTIVE SUMMARY

OBJECTIVE

The purpose of our review was to determine whether CareFirst complied with the pension segmentation requirements of the Medicare contract from January 1, 1991 through January 1, 2002.

FINDINGS

We found that CareFirst understated Medicare segment pension assets by \$6,788,644 as of January 1, 2002. The understatement was primarily due to:

- An improper reallocation of pension assets on January 1, 1996 (\$4,255,373 understatement).
- Incorrect identification of benefit payments (\$84,472 overstatement).
- Calculation of earnings and expenses using an incorrect asset base (\$2,617,743 understatement).

RECOMMENDATIONS

We recommend that CareFirst increase the Medicare segment pension assets by \$6,788,644 as of January 1, 2002. We also recommend that CareFirst change its methodology of computing transfer adjustments for future periods.

INTRODUCTION

BACKGROUND

Medicare

CareFirst administers Medicare Part A operations under cost reimbursement contracts. Previously, CareFirst also administered Medicare Part B operations. However, the Medicare Part B contract was terminated on December 31, 1994. In claiming costs, contractors were to follow cost reimbursement principles contained in the Federal Procurement Regulations (FPR), which were superseded by the Federal Acquisition Regulations (FAR), the Cost Accounting Standards (CAS), and the Medicare contracts. Since its inception, Medicare has paid a portion of the annual contributions made by contractors to their pension plans. These payments represented allowable pension costs under the FPR and/or the FAR. In 1980, both the FPR and Medicare contracts incorporated CAS 412 and 413.

The Centers for Medicare and Medicaid Services (CMS) incorporated segmentation requirements into Medicare contracts starting with fiscal year 1988. The contractual language specifies segmentation requirements and also provides for the separate identification of the pension assets for a Medicare segment.

The Medicare contract defines a segment and specifies the methodology for the identification and initial allocation of pension assets to the Medicare segment. Furthermore, the contract requires that the Medicare segment assets be updated for each year after the initial allocation in accordance with CAS 413.

Our previous segmentation review (report number A-07-93-00692) addressed the computation of the asset fraction, the identification of the segment's assets as of January 1, 1986 and the update of the segment's assets to January 1, 1991.

Regulations

The CAS 412 regulates the determination and measurement of the components of pension costs. It also regulates the assignment of pension costs to appropriate accounting periods. The CAS 413 regulates the valuation of pension assets, allocation of pension costs to segments of an organization, adjustment of pension costs or actuarial gains and losses, and assignment of gains and losses to cost accounting periods.

OBJECTIVES, SCOPE, AND METHODOLOGY

Objectives

Our objectives were to determine CareFirst's compliance with pension segmentation requirements of its Medicare contract and to determine the amount of Medicare segment pension assets as of January 1, 2002.

Scope

Achieving our objectives did not require a review of CareFirst's internal control structure. We reviewed CareFirst's identification of the Medicare segment and its update of Medicare assets from January 1, 1991 through January 1, 2002.

We performed this review in conjunction with our audits of unfunded pension costs (report number A-07-03-03039), and pension costs claimed for Medicare reimbursement (report number A-07-03-03036). The information obtained and reviewed during those audits was also used in performing this review.

Methodology

In performing the review, we used information provided by CareFirst's actuarial consulting firm. The information included liabilities, normal costs, contributions, benefit payments, investment earnings, and administrative expenses. We reviewed CareFirst's accounting records, pension plan documents, annual actuarial valuation reports, and the Department of Labor/Internal Revenue Service Form 5500s. Using these documents, CMS pension actuarial staff calculated Medicare segment assets as of January 1, 2002. We reviewed the methodology and calculations.

Details for the updated pension assets of the Medicare segment from January 1, 1991 through January 1, 2002 are presented in Appendix A.

We performed site work at CareFirst's corporate office in Owings Mills, Maryland during September and October of 2002 and January of 2003. We also performed audit work in our OIG, OAS offices in Kansas City and Jefferson City, Missouri.

Our audit was performed in accordance with generally accepted government auditing standards.

FINDINGS AND RECOMMENDATIONS

UPDATE OF MEDICARE SEGMENT ASSETS FROM JANUARY 1, 1991 THROUGH JANUARY 1, 2002

We updated Medicare segment pension assets from January 1, 1991 through January 1, 2002. We found that CareFirst understated segment assets by \$6,788,644 as of January 1, 2002. The understatement was primarily due to:

- An improper reallocation of pension assets on January 1, 1996 (\$4,255,373 understatement).
- Incorrect identification of benefit payments (\$84,472 overstatement).
- Calculation of earnings and expenses using an incorrect asset base (\$2,617,743 understatement).

CRITERIA

Determining segment assets is addressed by the Medicare contract, which states: "...the pension assets allocated to each Medicare segment shall be adjusted in accordance with CAS 413.50(c)(7)." Specifically, CAS 413.50(c)(7) requires that the asset base be adjusted by contributions, income, benefit payments, and expenses. In addition, an adjustment should also be made for transfers (participants who enter or leave the segment) if the transfer materially affects the segment's ratio of pension plan assets to actuarial accrued liabilities.

CONDITION AND CAUSE

Reallocation of Pension Assets on January 1, 1996

In our previous segmentation report (report number A-07-93-00692) we recommended that CareFirst increase Medicare pension assets from \$4,624,800 to \$6,558,297 (an increase of \$1,933,497) as of January 1, 1991. Although CareFirst agreed with our findings, they did not implement this recommendation. Furthermore, CareFirst did not update Medicare segment assets from January 1, 1991 through December 31, 1995. On January 1, 1996, CareFirst reallocated pension assets to the Medicare segment based on the ratio of the segment's actuarial liability (AL) to total company AL. CareFirst's reallocation resulted in Medicare segment assets of \$4,072,892.

During Calendar Years 1994 and 1995, the Medicare segment active participants decreased due to the termination of the Medicare Part B contract. Therefore, the Medicare segment AL, as a ratio of total company AL, was lower than historical values. Consequently, the reallocation resulted in an understatement of Medicare segment assets.

We updated the Medicare segment assets from January 1, 1991 to January 1, 1996 in accordance with CAS 413.50(c)(7). We determined the Medicare segment assets were \$8,328,265 as of January 1, 1996. Consequently, CareFirst's reallocation understated the Medicare segment assets by \$4,255,373 (\$8,328,265 less \$4,072,892). CareFirst's actuary indicated that they were unaware the reallocation was not in accordance with CAS 413.50(c)(7).

Update of Medicare Segment Assets

CareFirst updated the Medicare segment assets from January 1, 1996 through January 1, 2002 in accordance with CAS 413.50(c)(7). Although CareFirst's methodology was materially correct, the update understated Medicare segment assets by an additional \$2,533,271 as of January 1, 2002. This additional understatement resulted from incorrect benefit payments, and the calculation of earnings and expenses using an incorrect asset base.

Benefit Payments

CareFirst understated benefit payments by \$84,472. This understatement occurred because CareFirst incorrectly identified retirement benefit payments made to Medicare segment participants.

We identified the actual retirement benefits paid to Medicare segment participants through December 31, 2001 and assigned these payments to the Medicare segment. A comparison of CareFirst and OIG benefit payment amounts are shown on the following schedule:

Benefit Payments to Medicare Participants

<u>Year</u>	<u>CareFirst</u>	<u>OIG</u>	<u>Variance</u>
1996	\$ 88,541	\$ 11,739	\$76,802
1997	65,147	129,297	(64,150)
1998	291,165	209,007	82,158
1999	367,755	547,276	(179,521)
2000	392,291	392,211	80
2001	<u>179,739</u>	<u>179,580</u>	<u>159</u>
Total	<u>\$1,384,638</u>	<u>\$1,469,110</u>	<u>(\$84,472)</u>

Earnings and Expenses

CareFirst's net earnings were understated by \$2,617,743. The understatement was due primarily to the fact that CareFirst's update methodology allocated a portion of earnings and expenses based on a ratio of Medicare segment assets to total company assets. Because CareFirst's asset amounts were incorrect, it understated the segment's net

earnings for each year of the update. Except for using our adjusted values, we used CareFirst's allocation methodology for earnings and expenses in our update.

Transfers

CareFirst made adjustments for transfers (representing the movement of participants in and out of the segment each year) in its update of segment assets from January 1, 1996 to January 1, 2002. We determined that CareFirst correctly identified the participants that transferred in and out of the segment. However, we also determined that CareFirst used an incorrect AL in the computation of the transfer adjustments.

In accordance with CAS, codified at CFR 9904.413-50(c)(8), "If assets and liabilities are transferred, the amount of assets transferred shall be equal to the actuarial accrued liabilities, determined using the accrued benefit cost method, transferred."

CareFirst incorrectly computed transfer adjustments using the AL determined under the projected unit credit cost method instead of the AL determined under the accrued benefit cost method (ABCM). However, we do not believe that this error caused a material misstatement of the Medicare segment assets. Nevertheless, failure to compute transfers using the AL determined under the ABCM could result in material misstatement of segment assets in subsequent periods.

EFFECT

As of January 1, 2002, CareFirst understated Medicare segment pension assets by \$6,788,644.

RECOMMENDATIONS

We recommend CareFirst increase its Medicare segment assets by \$6,788,644 to \$12,553,607 as of January 1, 2002. We also recommend that CareFirst compute transfer adjustments for future periods based on the participants' AL determined under the ABCM.

Auditee's Comments

CareFirst agreed with our findings and recommendations. CareFirst noted that the Medicare segment asset total shown in the draft report Medicare asset segment total did not reconcile with the amount shown in the Appendix. We have corrected the Medicare segment asset total in the final report. CareFirst's response is included in its entirety as Appendix B.

INSTRUCTIONS FOR AUDITEE RESPONSE

Final determinations as to actions taken on all matters reported will be made by the CMS action official identified below. We request that you respond to the recommendation in this report within 30 days from the date of this report to the CMS action official, presenting any comments or additional information that you believe may have a bearing on final determination.

In accordance with the principles of the Freedom of Information Act, 5 U.S.C. 552, as amended by Public Law 104-231, OIG, OAS reports are made available to the public to the extent information contained therein is not subject to the exemptions in the Act. (See CFR Part 5). As such, within 10 days after the report is issued, it will be posted on the Internet at <http://oig.hhs.gov/>.

Sincerely,

A handwritten signature in black ink, appearing to read "James P. Aasmundstad".

James P. Aasmundstad
Regional Inspector General
for Audit Services

Enclosures

CAREFIRST OF MARYLAND
STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1991 THROUGH JANUARY 1, 2002

Description	Total Company	Other Segment	Medicare
Assets January 1, 1991 <u>1/</u>	\$ 45,917,813	\$39,359,516	\$6,558,297
Prepayment Transfers	0	0	0
Contributions <u>2/</u>	3,468,084	3,421,858	46,226
Earnings <u>3/</u>	6,080,047	5,211,653	868,394
Benefits <u>4/</u>	(2,283,456)	(2,190,276)	(93,180)
Expenses <u>5/</u>	(154,632)	(132,546)	(22,086)
Transfers <u>6/</u>	0	(61,579)	61,579
Assets January 1, 1992	\$53,027,856	\$45,608,626	\$7,419,230
Prepayment Transfers	0	0	0
Contributions	4,651,538	4,651,538	0
Earnings	3,440,382	2,959,031	481,351
Benefits	(3,879,264)	(3,846,814)	(32,450)
Expenses	(549,332)	(472,474)	(76,858)
Transfers	0	0	0
Assets January 1, 1993	\$56,691,180	\$48,899,907	\$7,791,273
Prepayment Transfers	0	0	0
Contributions	6,488,538	6,488,538	0
Earnings	4,781,995	4,124,788	657,207
Benefits	(4,424,865)	(4,309,666)	(115,199)
Expenses	(425,116)	(366,691)	(58,425)
Transfers	0	0	0
Assets January 1, 1994	\$63,111,732	\$54,836,876	\$8,274,856

CAREFIRST OF MARYLAND
STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1991 THROUGH JANUARY 1, 2002

Description	Total Company	Other Segment	Medicare
Assets January 1, 1994	\$63,111,732	\$54,836,876	\$8,274,856
Prepayment			
Transfers	0	0	0
Contributions	5,805,610	5,805,610	0
Earnings	(550,902)	(478,671)	(72,231)
Benefits	(3,132,522)	(2,926,547)	(205,975)
Expenses	(678,095)	(589,187)	(88,908)
Transfers	0	0	0
Assets January 1, 1995	\$64,555,823	\$56,648,081	\$7,907,742
Prepayment			
Transfers	0	0	0
Contributions	5,866,061	5,866,061	0
Earnings	14,102,252	12,374,802	1,727,450
Benefits	(5,406,027)	(4,183,237)	(1,222,790)
Expenses	(686,862)	(602,725)	(84,137)
Transfers	0	0	0
Assets January 1, 1996	\$78,431,247	\$70,102,982	\$8,328,265
Prepayment			
Transfers	0	0	0
Contributions	4,025,320	4,025,320	0
Earnings	8,619,619	7,682,211	937,408
Benefits	(3,810,933)	(3,799,194)	(11,739)
Expenses	(1,109,937)	(989,228)	(120,709)
Transfers	0	0	0
Assets January 1, 1997	\$86,155,316	\$77,022,091	\$9,133,225

CAREFIRST OF MARYLAND
STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1991 THROUGH JANUARY 1, 2002

Description	Total Company	Other Segment	Medicare
Assets January 1, 1997	\$86,155,316	\$77,022,091	\$9,133,225
Prepayment Transfers	0	0	0
Contributions	5,227,828	5,227,828	0
Earnings	14,732,817	13,143,527	1,589,290
Benefits	(4,984,192)	(4,854,895)	(129,297)
Expenses	(740,207)	(660,358)	(79,849)
Transfers	0	(625,033)	625,033
Assets January 1, 1998	\$100,391,562	\$89,253,160	\$11,138,402
Prepayment Transfers	0	0	0
Contributions	3,001,729	3,001,729	0
Earnings	11,388,416	10,118,124	1,270,292
Benefits	(6,159,481)	(5,950,474)	(209,007)
Expenses	(639,853)	(568,482)	(71,371)
Transfers	0	75,692	(75,692)
Assets January 1, 1999	\$107,982,373	\$95,929,749	\$12,052,624
Prepayment Transfers	0	0	0
Contributions	400,000	400,000	0
Earnings	19,444,136	17,239,506	2,204,630
Benefits	(8,472,066)	(7,924,790)	(547,276)
Expenses	(591,856)	(524,750)	(67,106)
Transfers	0	(28,609)	28,609
Assets January 1, 2000	\$118,762,587	\$105,091,106	\$13,671,481

CAREFIRST OF MARYLAND
STATEMENT OF MEDICARE PENSION ASSETS
JANUARY 1, 1991 THROUGH JANUARY 1, 2002

Description	Total Company	Other Segment	Medicare
Assets January 1, 2000	\$118,762,587	\$105,091,106	\$13,671,481
Prepayment Transfers	0	0	0
Contributions	300,000	300,000	0
Earnings	(1,325,136)	(1,169,682)	(155,454)
Benefits	(8,071,498)	(7,679,287)	(392,211)
Expenses	(978,010)	(863,278)	(114,732)
Transfers	0	(4,173)	4,173
Assets January 1, 2001	\$108,687,943	\$95,674,686	\$13,013,257
Prepayment Transfers	0	0	0
Contributions	6,307,525	6,307,525	0
Earnings	(1,562,688)	(1,368,878)	(193,810)
Benefits	(9,581,894)	(9,402,314)	(179,580)
Expenses	(651,251)	(570,481)	(80,770)
Transfers	0	5,490	(5,490)
Assets January 1, 2002	\$103,199,635	\$90,646,028	\$12,553,607
Assets January 1, 2002	\$103,199,635	\$90,646,028	\$12,553,607
Per CareFirst	<u>7/</u> 103,199,635	97,434,672	5,764,963
Asset Variance	<u>8/</u> \$0	(\$6,788,644)	\$6,788,644

FOOTNOTES

1. We determined the Medicare segment assets as of January 1, 1991 in our prior review of CareFirst's pension segmentation (A-07-93-00692). The amounts shown for the other segment represent the difference between the total company and the Medicare segment. All pension assets are shown at market value.
2. We obtained total company contribution amounts from the actuarial valuation reports. We allocated total company contributions to the Medicare segment based on the ratio of the Medicare segment's funding target divided by the total company's funding target.
3. We obtained investment earnings from actuarial valuation reports. CareFirst allocated its investment earnings based on a ratio of segment assets to total company assets. We used the same methodology.
4. We based the Medicare segment's benefit payments on actual payments to Medicare retirees. CareFirst provided us with a schedule of Medicare participants' benefit payments. We obtained supporting documentation from CareFirst to verify payment dates and amounts.
5. We calculated the total Medicare segment administrative expenses based on a ratio of segment assets to total company assets. CareFirst used the same methodology.
6. We identified participant transfers between segments by comparing annual data files provided by CareFirst.
7. We obtained total asset amounts as of January 1, 2002 from CareFirst's actuarial valuation report.
8. The asset variance represents the difference between the OIG calculation of Medicare segment assets and CareFirst's actuarially reported Medicare segment.

April 9, 2003

James P. Aasmundstad
Office of Audit Services
Region VII
601 East 12th Street, Room 284A
Kansas City, MO 64106

Reference: **Response for Draft Report Number A-07-03-03033**

Dear Aasmundstad:

Attached is the Pension Audit Report response to the Review of Medicare Contractor's Pension Segmentation, CareFirst of Maryland for contract years from January 1, 1991 through January 1, 2002.

Finding

Update of Medicare Segment Assets from January 1, 1991 through January 1, 2002.

Recommendation

We recommend CareFirst increase its Medicare segment assets by \$6,788,645 to \$12,533,608 as of January 1, 2002. We also recommend that CareFirst compute transfer adjustments for future periods based on the participants' actuarial liability determined under the Accrued Benefit Cost Method (ABCM).

Response:

CareFirst agrees that both the Medicare and non-Medicare segment assets should be revised, increasing the assets for the Medicare segments and decreasing the assets for the non-Medicare segment. We will calculate future CAS costs using the revised assets. In addition, we will compute transfers under the Accrued Benefit Cost Method.

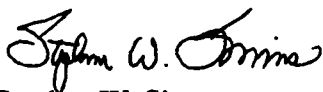
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CareFirst of Maryland, Inc.
Report A-07-03-03033 Review of Medicare Contractor's Pension Segmentation
April 9, 2003
Page 2 of 2

Per page 6 of the report the January 1, 2002 asset balance is \$12,533,608 vs. \$12,553,607 as shown on Appendix A of the report. Please inform us of the correct amount.

If you have questions, please contact me at 410-561-4270.

Sincerely,



Stephan W. Simms
Director,
Intermediary Operations

cc: Angela Miller
Charlie Reip
Bruce Keaton
Jimmy Riggs
Cheryl Tillman, Aon
Rachel Rosenblatt, Aon